

**HI3042 Taxation Law**

**T2 2017 Individual Assignment**



## Question 1

### Answer:

As per section 8-1 of ITAA 1997, any loss or outgoing is deductible from the assessable income to the amount that is incurred in generating the assessable income; or it is inevitably incurred in carrying on the business for generating the assessable income. On the other hand, there will be no deduction under the said section if the amount is of capital nature; or private or domestic nature; or it is incurred for generating exempt income or non-assessable income, or for a reason being the Act prevent from deducting the same. Hence:

- i. The cost incurred in shifting depreciable assets to new site is capital costs and therefore not deductible under sec.8-1 ITAA 1997. Such cost will increase the assets cost for depreciation purpose.
- ii. For deductibility of the cost, it is significant to verify that whether the cost is of revenue or capital nature. If the cost is of revenue nature, the benefits are short term, and cost is recurring nature, then the deduction will be available under sec.8-1 ITAA 1997. The expenses of revaluing fixed assets are used to increase income generating capability. Therefore, the same will be considered as capital expenditure and hence will not be allowed for deduction.
- iii. The deduction of the legal expenses depends on the intention of incurring expenses. Legal expenses are deductible under the section 8-1 if incurred in earning assessable income. Hence, the legal expenses incurred in opposing a petition for winding up are of capital nature and consequently will not be allowed as a deduction under the said section.
- iv. The High Court in the case of *Tin NL v FCT* held that there should be a direct nexus between the legal expenses incurred and business for claiming the deduction. Conversely, there will be no deduction of the legal expenditure if it is of capital nature. Therefore, legal expenses incurred for services of a solicitor in respect of matters relating to client's business operations would be considered recurring expenditures and hence will be allowed as deduction.

(Commonwealth Consolidated Acts, 1997)

(Michael Clough, Mallesons Stephen Jaques, 2006)

## Question 2

### Answer:

As per (Australian Taxation Office, 2015) for claiming GST credits following four conditions must be satisfied:

- i. Taxpayer intends to use the purchase solely or partly in carrying on the business and the purchase does not relate to making input-taxed supplies.
- ii. The purchase price included GST.
- iii. Taxpayer provides, or is liable to provide, payment for the item purchased.
- iv. The taxpayer has a tax invoice from the supplier (for purchases more than \$82.50).

“If your tax invoice does not specify the amount of GST included in the price of your purchase and only states that the price includes GST, you can work out the GST amount yourself by dividing the price by 11. The answer is the amount of GST credit you can claim (provided you use the item wholly for business purposes).” (Australian Taxation Office, 2015)

Under the GST Act if the person has acquired creditable acquisitions then same will be allowed to input tax credit of the same amount equal to the GST payable on the supply. The *creditable acquisition* is defined in the legislation as anything solely or partly for a creditable purpose; and the supply is a taxable supply; and the person receiving supply is liable to provide consideration for that; and the person is required to be registered. Creditable purpose here means a thing for a creditable intention to the level that the person acquires it in carrying on the enterprise. (Denham Martin & Associates, 2001)

In the given case, Big Bank Ltd. is registered for GST purposes and is engaged in the business of providing loans and deposit facilities to its customers in Australia. Last year it launched a new product of policies of home and contents insurance. The bank has allocated a sum of \$550,000 for television advertising campaign specifically promoting home and contents insurance policies and \$1,100,000 for general advertising campaign for promoting the bank as a whole. The total amount of \$1,650,000 budgeted to spend is inclusive of GST. The bank has forecasted that its insurance business would be 2% of its total business and remaining 98% would be loans and deposit facilities business.

The creditable acquisitions associated with the loans and deposits would not be available for credit under GST. Creditable acquisitions related to home and contents insurance would be available fully for credit. Therefore, input tax credit for \$550,000 that is \$50,000 ( $\$550,000 / 11$ ) would be available. Similarly, general advertisement related credit will be apportioned on the basis of appropriate method like attributing 2% of the advertisement expenditure for taxable supplies and 98% for input taxed supplies. Therefore, there will be input tax credit of \$2,000 ( $\$1,100,000/11 \times 2\%$ ).

### Question 3

#### Answer:

If the taxpayer has income from other foreign countries, then he has to declare such income in the Australian income tax return. If the taxpayer has paid any amount as the foreign tax in another country, then it will be allowed relief from double taxation as Australian foreign income tax offset. The taxpayer can claim the tax offset for the foreign tax paid on all forms of income, profits or gains (including gains of a capital nature) that are included in his Australian assessable income.

There is a limit of \$1,000 for the offset for a year. If the taxpayer wants to claim offset above \$1,000, then he has to calculate foreign income tax offset limit. Conversely, any excess amount paid above the limit will not be available for carry forward and also cannot be refunded. (Commonwealth Consolidated Acts, 1997)

Angelo's foreign income tax offset limit shall be as follows:

	<b>Particulars</b>	<b>\$</b>
	Employment income from Australia	44,000.00
	Employment income from United States	12,000.00
	Employment income from United Kingdom	8,000.00
	Rental income from property in United Kingdom	2,000.00
	Dividend income from United Kingdom	1,200.00
	Interest income from United Kingdom	800.00
	<b>Total gross income (i)</b>	<b>68,000.00</b>

	Expenses incurred in deriving employment income from Australia	4,000.00
	Expenses incurred in deriving employment income from United States	900.00
	Expenses incurred in deriving rental income from United Kingdom	500.00
	Gift to deductible gift recipient	400.00
	Interest (debt deduction) incurred in deriving dividend income	140.00
	Expenses (debt deduction) incurred in deriving interest income	60.00
	<b>Total Expenses (ii)</b>	<b>6,000.00</b>
	<b>Taxable income (iii = i-ii)</b>	<b>62,000.00</b>

	<b>Foreign tax paid:</b>	
	Employment income from United States	3,600.00
	Dividend income from United Kingdom	120.00
	Interest income from United Kingdom	80.00
	Rental income from United Kingdom	600.00
	<b>Total foreign income tax paid (iv)</b>	<b>4,400.00</b>

<b>Step: 1</b>	<b>Tax payable on taxable income</b>	
	Total Taxable Income	62,000.00
	Taxable income after reducing exempt slab amount (\$18,200)	43,800.00
	Tax on \$38,800	5,782.00
	Medicare levy (iii * 2%)	1,240.00
	<b>Total Tax Payable (including Medicare Levy) (v)</b>	<b>7,022.00</b>

<b>Step: 2</b>	<b>Tax payable if income does not include foreign income</b>	
	Employment income from United States	12,000.00
a)	Employment income from United Kingdom	8,000.00
	Rental income from United Kingdom	2,000.00
	Dividend income from United Kingdom	1,200.00
	Interest income from United Kingdom	800.00
	<b>Total (vi)</b>	<b>24,000.00</b>
	Disregarded expenses	
b)	Expenses incurred in deriving employment income from United States	900.00
	Expenses incurred in deriving rental income from United Kingdom	500.00
	<b>Total (vii)</b>	<b>1,400.00</b>

	Taxable Income (viii = i-vi)	<b>44,000.00</b>
	Allowable deductions (ix = ii-vii)	<b>4,000.00</b>
	<b>Taxable Income (x = viii - ix)</b>	<b>40,000.00</b>
	(xi = x - \$18,200)	21,800.00
	Tax (xi * 19%)	4,142.00
	Medicare Levy (x * 2%) (xiii)	800.00
	<b>Total Tax Payable (including Medicare Levy) (xiv = xii+xiii)</b>	<b>4,942.00</b>
<b>Step: 3</b>	<b>Foreign Income Tax Offset Limit (xv = v - xiv)</b>	<b>2,080.00</b>

This is Angelo's foreign income tax offset limit.

**Question 4****Answer:**

Calculation of net income for the partnership for the year:

	\$
<b><i>Receipt:</i></b>	
Sales of sporting goods (Note – 1)	400,000.00
Interest on bank deposits (Note – 1)	10,000.00
Dividend franked to 60% received from an Australian resident company (Note – 2 and 3) ( $\$21000 \times 30/70 \times 60\%$ )	5,400.00
Bad debt recovered (Note - 4)	10,000.00
Exempt income (Note - 5)	-
Capital loss from disposal of shares acquired in 2009 and sold in June this income year (Note - 6)	7,500.00
<b>Total</b>	<b>432,900.00</b>

<b><i>Payments and Deductions:</i></b>	
Cash stolen by an employee from sales to customers (Note - 7)	3,000.00
Salary to Partners (Note - 8)	-
Fringe Benefit Tax (Note - 9)	16,000.00
Interest on Capital provided by Johnny (Note - 10)	2,000.00
Interest on loan made by Johnny to the partnership (Note - 11)	-
Travel expenses of Johnny between home and office (Note - 12)	-
Legal fees for the renewal of lease of the office building (Note - 13)	2,000.00
Legal expenses for preparation of a partnership agreement (Note - 13)	240.00
Legal expenses for preparation of new lease of business premises (Note - 13)	700.00
Debt collection expenses paid to a solicitor (Note - 14)	500.00
Council rates on business premises (Note - 14)	500.00
Staff Salaries ( $\$25,000 - 5,000$ ) (Note - 15)	20,000.00
Purchase of sporting goods supplies (Note - 14)	30,000.00
Rent on retail shop (Note - 14)	-
Provision for doubtful debts (Note - 16)	

	30,000.00
Business Lunches (Note - 17)	10,000.00
Excess of opening stock over closing stock (\$20,000 – 16,000) (Note - 18)	4,000.00
Net loss of last income year (Note - 19)	-
<b>Total</b>	<b>118,940.00</b>
<b>Net income of partnership</b>	<b>313,960.00</b>

**Notes:**

1. As per Income Tax Assessment Act, 1997- Section 6.5, the person being resident in Australia, his assessable income will be computed considering the ordinary income that the resident has derived directly or indirectly from all sources during the income year. (Commonwealth Consolidated Acts, 1997)
2. The dividend income of a resident being a shareholder in the company (resident or non-resident), shall be included his assessable income if the dividend by the company paid out of profits derived by it from any source. (Commonwealth Consolidated Acts, 1997)
3. As per Income Tax Assessment Act, 1997 – Section 207-20(2), the person receiving franked dividend shall be entitled to tax offset which is equal to franking credit on the distribution. (AustralianTaxationOffice, INCOME TAX ASSESSMENT ACT 1997, 1997)
4. Section 20-30 of ITAA 1997, specifically allows including any recovery of bad debts to reverse the effect of past deductions. (AustralianTaxationOffice, INCOME TAX ASSESSMENT ACT 1997, 1997)
5. As per Section 6.20 of ITAA 1997, if any income made exempt from income tax then such income is exempt income and will not be taken in calculating the tax. (Commonwealth Consolidated Acts, 1997)
6. The Capital loss arising from CGT concerning a partnership shall be calculated individually with reference to the partnership agreement. Section 106.5 – ITAA 1997 (Commonwealth Consolidated Acts, 1997) [Capital Gain=30000-15000-50%\*15000=7500]
7. Any loss by theft etcetera shall be allowed as a deduction from income if the loss discovered in the income year or caused by theft, stealing; and then such amount has been included in assessable income of the year or for the earlier year. Section 25.45 – ITAA 1997 (Commonwealth Consolidated Acts, 1997)
8. As per Case Scott v. FC of T (2002) 50 ATR 1235; 2002 ATC 2158, the salary to partners from profits of the partnership cannot be allowed as the deduction under section 8-1 of the ITAA 1997. (AustralianTaxationOffice, Income tax: the taxation implications of 'partnership salary' agreements , 2005)
9. The assessee shall be entitled to deduct any loss or outgoing to the extent it is incurred in carrying on a business for generating assessable income. Section 8.1 – ITAA 1997. (Commonwealth Consolidated Acts, 1997)
10. Interest paid to partners on their capital induction shall not be treated as an expense for



the partnership and hence not deductible. Case Roberts and Smith v FCT – TR 95/25. (AustralianTaxationOffice, Taxation Ruling TR 95/25, 1995)

11. Interest on loan given by partner to the partnership is a deductible expense.
12. Partners' personal expenses are treated as drawings and hence drawings are not deductible.
13. Legal expenses if incurred in earning assessable income; are allowable as a deduction under section 8-1 of ITAA 1997. If the expenses related to capital nature then such expenses will not be allowed as deduction. Under section 40-880, expense incurred to establish the business structure 20 per cent of the expenditure is deductible in the income year in which it is incurred for the next four years. (Michael Clough, Mallesons Stephen Jaques, 2006)
14. As per section 8.1 of ITAA 1997, any outgoing or loss to the extent it is incurred in generating assessable will be allowed as general deduction. (Commonwealth Consolidated Acts, 1997)
15. As per section 26.35 of ITAA 1997, the amount of staff salaries to be deducted to the extent as the Commissioner consider reasonable. (Commonwealth Consolidated Acts, 1997)
16. As per section 25.35 of ITAA 1997, only bad debts written off in the income year will be allowed as a deduction and not the provision for bad debts. (Commonwealth Consolidated Acts, 1997)
17. As per section 32.5 of ITAA 1997, the deduction for entertainment expenses will not be allowed. The expenses of business lunch at expensive restaurants are in the nature of business expenses and therefore shall be allowed as deduction. (Commonwealth Consolidated Acts, 1997)
18. There shall be a deduction of the excess of the value of opening stock over closing stock. Section 70-35(3) ITAA 1997. (AustralianTaxationOffice, INCOME TAX ASSESSMENT ACT 1997, 1997)
19. As the net loss of partnership of last income year had attributed to the partners in last income year, therefore no further deduction will be available.

## Bibliography

Acts, C. C. (1997). *INCOME TAX ASSESSMENT ACT 1997 - SECT 6.5 Income according to ordinary concepts (ordinary income)*. Retrieved from [http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol\\_act/itaa1997240/s6.5.html](http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol_act/itaa1997240/s6.5.html)

Australian Taxation Office, A. G. (2015). *When you can claim a GST credit*. Retrieved from <https://www.ato.gov.au/business/gst/claiming-gst-credits/when-you-can-claim-a-gst-credit/>

AustralianTaxationOffice. (1997). *INCOME TAX ASSESSMENT ACT 1997*. Retrieved from <https://www.ato.gov.au/law/view/document?Docid=PAC/19970038/20-30>

AustralianTaxationOffice. (1997). *INCOME TAX ASSESSMENT ACT 1997*. Retrieved from <https://www.ato.gov.au/law/view/document?DocID=PAC/19970038/70-35>

AustralianTaxationOffice. (2005). *Income tax: the taxation implications of 'partnership salary' agreements*. Retrieved from <http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR20057/NAT/ATO/00001>

AustralianTaxationOffice. (1995). *Taxation Ruling TR 95/25*. Retrieved from <https://www.ato.gov.au/law/view/document?DocID=TXR/TR9525/NAT/ATO/00001>

Commonwealth Consolidated Acts, A. (1997). *INCOME TAX ASSESSMENT ACT 1997 - SECT 32.5 No deduction for entertainment expenses*. Retrieved from [http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol\\_act/itaa1997240/s32.5.html](http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol_act/itaa1997240/s32.5.html)

CommonwealthConsolidatedAct. (1997). *INCOME TAX ASSESSMENT ACT 1997 - SECT 770.75 Foreign income tax offset limit*. Retrieved from [http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol\\_act/itaa1997240/s770.75.html](http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol_act/itaa1997240/s770.75.html)

Denham Martin & Associates. (2001). *Input Tax Credits - The Core Mechanism of GST*. Retrieved from [http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/June\\_2001,\\_Sound\\_Education\\_in\\_GST,\\_Input\\_Tax\\_Credits\\_\\_\\_The\\_Core\\_Mechanism\\_of\\_GST.html](http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/June_2001,_Sound_Education_in_GST,_Input_Tax_Credits___The_Core_Mechanism_of_GST.html)

Michael Clough, Mallesons Stephen Jaques. (2006). *The Deductibility of Legal Expenses*. Retrieved from [http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/August\\_2006,\\_Sound\\_Education\\_in\\_Taxation,\\_The\\_Deductibility\\_of\\_Legal\\_Expenses.html](http://www.tved.net.au/index.cfm?SimpleDisplay=PaperDisplay.cfm&PaperDisplay=http://www.tved.net.au/PublicPapers/August_2006,_Sound_Education_in_Taxation,_The_Deductibility_of_Legal_Expenses.html)

SECT-6.5, I. T. (1997). *INCOME TAX ASSESSMENT ACT 1997 - SECT 6.5 Income according to ordinary concepts (ordinary income)*. Retrieved from [http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol\\_act/itaa1997240/s6.5.html](http://www.austlii.edu.au/cgi-bin/viewdoc/au/legis/cth/consol_act/itaa1997240/s6.5.html)